United Nations E/2018/63

Economic and Social Council

Distr.: General
8 May 2018

Original: English

2018 session
27 July 2017–26 July 2018
Agenda item 5
High-level segment

World economic situation and prospects as of mid-2018*

Summary

Short-term prospects for the world economy have continued to improve. World gross product is expected to expand by 3.2 per cent in 2018 and 2019, marking an upward revision of the forecasts released in December 2017. The recent improvement reflects a further uptick in the growth outlook for developed economies in 2018, on the strength of accelerating wage growth, broadly favourable investment conditions and the short-term impact of a fiscal stimulus package in the United States of America. Higher energy and metal prices are also supporting a gradual recovery in many commodity-exporting countries.

The improvement in economic growth, however, has been accompanied by an increase in downside risks, including: the growing probability of trade conflicts between major economies; increased uncertainty regarding the pace of monetary policy adjustment in developed economies; high and increasing levels of debt; and greater geopolitical tensions.

The current economic picture has important implications for progress towards meeting the Sustainable Development Goals of the 2030 Agenda for Sustainable Development. The continued improvement in global macroeconomic conditions offers an opportunity to raise living standards on a broad scale; however, that requires policies to reduce inequality and ensure that economic gains are shared widely. The recent acceleration in economic growth has come at an environmental cost and was partly responsible for the rise in global energy-related carbon dioxide (CO_2) emissions in 2017. Efforts to decouple economic growth from increases in emissions have thus far been insufficient to meet the objectives of the Paris Agreement. In trade, policymakers face an increasing tendency to move away from the multilateral framework.

* The present document updates *World Economic Situation and Prospects 2018* (United Nations publication, Sales No. E.18.II.C.2), released in December 2017.

18-06457 (E) 150518

Please recycle

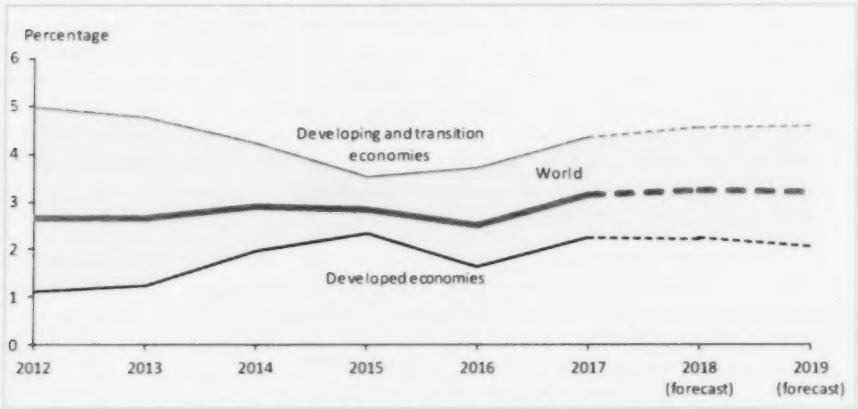
I. Global macroeconomic trends

A. Global overview

Improved short-term prospects

1. It was noted in the *World Economic Situation and Prospects 2018* that the world economy had strengthened in 2017. Over the past several months, short-term prospects have continued to improve. World gross product is expected to expand by 3.2 per cent in 2018 and 2019 (see figure I and table), marking an upward revision of the forecasts released in December 2017. The recent improvement reflects a further uptick in the growth outlook for developed economies in 2018, on the strength of accelerating wage growth, broadly favourable investment conditions and the short-term impact of a fiscal stimulus package in the United States of America. World trade growth has accelerated, reflecting a widespread revival of demand. Many commodity-exporting countries will also benefit from higher energy and metal prices. The modest rise in global commodity prices will exert some upward pressure on inflation in many countries but inflationary pressures remain contained across most developed and developing regions.

Figure I
Growth in gross domestic product, 2012–2019



Source: Department of Economic and Social Affairs.

Build-up of risks

2. In parallel with the improvement in economic growth, however, there has been a rise in risks to the economic outlook, including: the growing probability of trade conflicts between major economies; increased uncertainty regarding the pace of monetary policy adjustment in the United States; high and increasing levels of debt; elevated asset valuations, which may in some cases indicate underpriced risk; and an undercurrent of geopolitical tension, for instance on the Korean peninsula and in the Middle East, in the South China Sea and in Ukraine.

Table
Growth of world output, 2016–2019

	Annual percentage change				*Change from World Economic Situation and Prospects 2018 forecast*[a]	
	2016	*2017*[b]	*2018*[c]	*2019*[c]	*2018*	*2019*
World	2.5	3.1	3.2	3.2	0.2	0.1
Developed economies	1.6	2.3	2.2	2.1	0.2	0.2
United States of America	1.5	2.3	2.5	2.3	0.4	0.2
Japan	0.9	1.7	1.6	1.5	0.4	0.5
European Union	2.0	2.4	2.2	2.0	0.1	0.0
EU-15	1.9	2.2	2.0	1.8	0.1	0.0
EU-13	3.1	4.6	3.9	3.6	0.2	0.1
Euro area	1.8	2.3	2.1	1.9	0.1	0.1
Other developed countries	1.9	2.4	2.3	2.3	-0.1	0.1
Economies in transition	0.3	2.0	2.1	2.2	-0.1	-0.2
South-Eastern Europe	3.0	2.2	3.0	3.4	-0.1	0.1
Commonwealth of Independent States and Georgia	0.2	2.0	2.1	2.1	-0.1	-0.2
Russian Federation	-0.2	1.5	1.7	1.7	-0.2	-0.2
Developing economies	4.0	4.6	4.8	4.8	0.1	0.0
Africa	1.6	3.7	3.6	3.9	0.1	0.2
North Africa	2.7	6.6	4.5	4.8	0.3	0.6
East Africa	5.5	5.7	6.0	6.1	0.2	-0.1
Central Africa	-1.0	-0.1	1.8	2.8	-0.2	0.3
West Africa	0.2	2.2	3.5	3.4	0.2	0.0
Southern Africa	0.7	1.4	1.9	2.3	-0.4	-0.2
East and South Asia	6.1	6.0	5.9	5.9	0.1	0.0
East Asia	5.7	6.1	5.8	5.7	0.0	0.0
China	6.7	6.9	6.5	6.3	0.0	0.0
South Asia	8.0	6.0	6.6	6.8	0.2	-0.1
India[d]	7.1	6.7	7.5	7.6	0.3	0.2
Western Asia	3.2	3.0	3.3	2.7	0.9	0.0
Latin America and the Caribbean	-0.9	1.0	2.1	2.5	0.0	0.0
South America	-2.4	0.6	1.9	2.5	0.0	0.0
Brazil	-3.5	1.0	2.4	2.7	0.4	0.2
Mexico and Central America	3.0	2.3	2.5	2.6	-0.1	0.0
Caribbean	-0.5	0.3	2.0	2.2	0.2	0.3
Least developed countries	3.9	4.7	5.2	5.5	-0.1	0.0
Memorandum items:						
World trade[e]	2.4	4.3	3.8	3.8	0.3	0.2
World output growth with purchasing power parity-based weights	3.2	3.7	3.9	3.8	0.2	0.1

Source: Department of Economic and Social Affairs.

[a] Adjusted to 2012 prices.

[b] Partly estimated.

[c] Forecast, based in part on Project LINK.

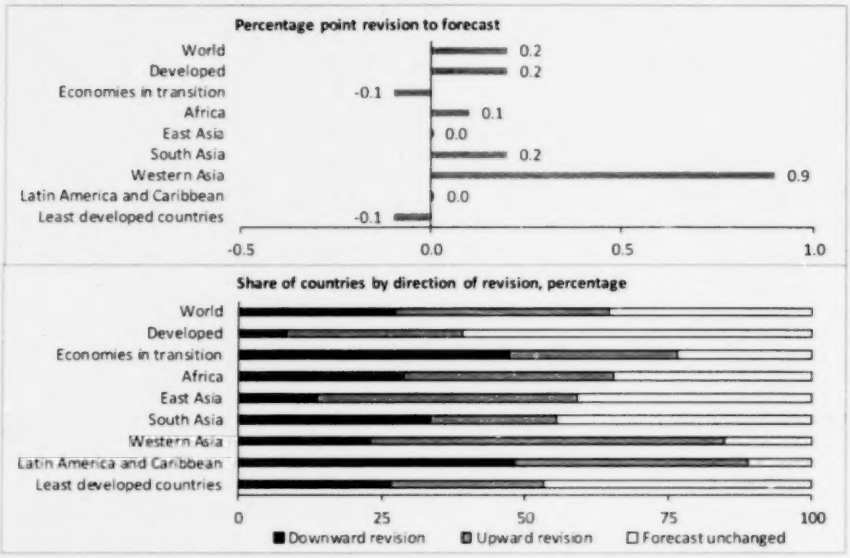
[d] Fiscal year basis.

[e] Includes goods and services.

Some regions lagging behind

3. Forecasts for gross domestic product (GDP) growth in 2018 have been revised upward in nearly 40 per cent of countries since December (see figure II) and downward in about 25 per cent of countries. Some countries and regions are not sharing in the global cyclical upturn, which in many cases reflects structural impediments to development. In per capita terms, output is expected to decline in Central and in Southern Africa in 2018. Forecasts for the economies in transition and the least developed countries have been revised marginally downward for 2018. For the economies in transition, the downward revision predominantly reflects rising geopolitical tensions between the Russian Federation and several countries. In the case of the least developed countries, weaker growth prospects are largely driven by the deteriorating situation in Yemen.

Figure II
Forecast revisions for GDP growth in 2018



Source: Current Department of Economic and Social Affairs forecasts compared with those reported in *World Economic Situation and Prospects 2018*.

4. It is estimated that GDP growth in the least developed countries will reach 5.2 per cent in 2018 and 5.5 per cent in 2019, continuing a steady acceleration since 2015. Some large least developed countries, including Bangladesh, Cambodia, Ethiopia, Myanmar and the United Republic of Tanzania, are growing at an average annual rate in line with the 7 per cent cited in target 8.1 of the Sustainable Development Goals but many small island developing States and countries affected by conflict remain well below that target. Per capita economic growth in the least developed countries is rising steadily, although at levels insufficient to eradicate extreme poverty: longer-term growth projections point to 35 per cent of the population in those countries remaining in extreme poverty by 2030.[1] Faster GDP growth and a significant reduction in income inequality would be needed to alter that outcome.

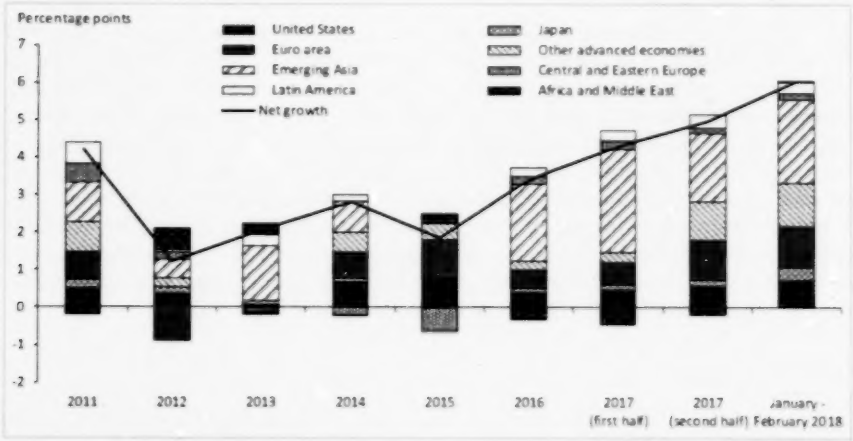
[1] *World Economic Situation and Prospects 2017* (United Nations publication, Sales No. E.17.II.C.2), pp. 25–27.

5. As emphasized in *World Economic Situation and Prospects 2018*, the improvement in macroeconomic conditions offers policymakers greater scope to address some of the deeply rooted barriers that hamper progress towards the Sustainable Development Goals, including by: accelerating the process of economic diversification; tackling high or rising levels of inequality; supporting essential investment; and strengthening institutions and governance to build a more transparent and dynamic business environment. The ongoing rise in economic risks makes meeting that challenge all the more imperative, in order to build resilience in advance of any future economic shocks.

World trade growth

6. In the first two months of 2018, growth in the volume of world merchandise trade strengthened further (see figure III), in tandem with the continued improvement in global manufacturing output. All regions contributed positively to global import demand for the first time in several years, reflecting a broad-based revival of demand. That was driven in part by the ongoing recovery in investment activity in the developed economies and solid domestic demand in East Asia, in particular China. Strong global demand for electronics has also boosted intraregional trade activity in East Asia, given the region's deep integration into the industry's global production networks.

Figure III
Contribution to global merchandise import volume growth (year-on-year), 2011–2018



Source: Department of Economic and Social Affairs, based on data from CPB Netherlands Bureau for Economic Policy Analysis.

Note: Regional groupings are not strictly comparable with those contained in *World Economic and Social Prospects 2018* but rather are illustrative of regional tendencies.

7. Leading indicators in many developed and developing countries point to solid, albeit more moderate, trade momentum in subsequent months of 2018. Following growth of 4.3 per cent in 2017, the volume of global trade in goods and services is projected to moderate slightly but continue expanding at a relatively robust pace of 3.8 per cent in 2018 and 2019. Nonetheless, there are significant downside risks to these forecasts, given the growing uncertainty regarding trade policy and rising number of trade disputes among major economies, as discussed below.

8. The strong recovery in global import demand continues to push up energy and metal prices. The price of Brent crude averaged $68 per barrel in the first four months of 2018, compared with $54 per barrel in 2017. Metal prices are projected to continue recovering in 2018, driven by robust industrial production, in particular in China. Agricultural prices are projected to remain stable, although they are prone to localized spikes relating to drought and conflict in parts of Western Asia and Africa.

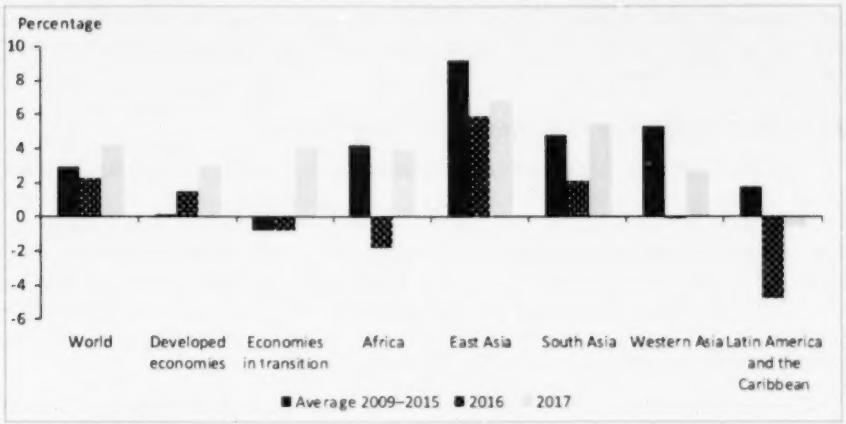
9. Global financial conditions remain broadly favourable, given the still largely loose monetary policy stances of the major central banks, high market liquidity and the generally well-capitalized banking systems in developed economies. Despite some increase in volatility, global stock market sentiment and expectations for corporate earnings are largely positive and cross-border bank lending continues to recover. Equity and bond flows to emerging economies have improved since the slump observed in 2015 and 2016. That has contributed to the maintenance of relatively low borrowing costs and spreads.

Accelerated investment growth

10. Against that backdrop, investment conditions have improved since early 2017. Investment growth accounted for more than three quarters of the acceleration in global economic activity in 2017. In particular, private, non-residential investment growth in developed countries has been more robust: machinery and equipment investment accelerated in 2017 in a number of large economies, including Canada, France, Germany, Japan, Spain and the United States. That recent improvement, however, follows an extended period of relatively weak investment growth since the global financial crisis of 2008 and 2009 (see figure IV).

11. The recent performance of investment is more heterogeneous in developing and transition economies. Investment demand has been vigorous in East Asia, for example in Indonesia, Malaysia and the Philippines, amid robust trade growth, accelerating manufacturing production and public infrastructure outlays. The investment outlook has also improved in some commodity-dependent economies, such as Brazil, Chile, Nigeria, Peru and the Russian Federation, as prices of key commodities have moved upward. In many low-income countries, in particular in parts of Africa, where the marginal return to any investment tends to be relatively high, the level of investment appears to be insufficient to achieve more sustained and inclusive growth. Moreover, investment remains highly concentrated in extractive industries, rather than being used to lay the foundations for a more diversified economy.

Figure IV
Investment growth by region, 2009–2017



Source: Department of Economic and Social Affairs estimates.

B. Macroeconomic policy stance

Gradual monetary policy adjustment in developed economies

12. In the developed economies, the process of monetary policy adjustment is expected to continue at a measured pace, as inflation remains close to or below most central bank targets. The deflationary pressures that were a major source of policy concern in 2015 and 2016 have subsided. In response to stronger growth and improved labour market conditions, a few central banks have recently signalled a slightly faster pace of monetary adjustment and balance sheet normalization going forward.

13. In March, the Federal Reserve Bank of the United States raised the target range for the federal funds rate by 25 basis points to 1.5–1.75 per cent, maintaining its expectations for two further rate hikes in 2018. At the same time, it lifted its projections for 2019 to three hikes. The European Central Bank recently dropped an explicit commitment to purchase additional assets should economic activity deteriorate. That follows its decision in 2017 to reduce the amount of its monthly asset purchases. Nevertheless, the Bank reiterated that interest rates would remain at the current near-zero levels for an extended period. Meanwhile, the Bank of England signalled a further rate hike in 2018. By contrast, the Bank of Japan is expected to maintain its ultra-loose monetary policy stance, reflecting the continued divergence in the magnitude and timing of monetary policy adjustments among the developed countries.

14. In most developing and transition economies, monetary policy is likely to remain supportive of growth, amid benign inflationary pressures and heightened uncertainty in the external environment. Nonetheless, it is expected that a growing number of countries will gradually reduce the level of monetary accommodation. Prolonged accommodative monetary conditions have contributed to a build-up of debt in several countries, posing a growing policy challenge for central banks.

15. In early 2018, a few large commodity exporters, including Argentina, Brazil, Colombia, the Russian Federation, South Africa and Zambia, lowered interest rates further to support the nascent economic recovery. As growth stabilizes, however, the monetary easing cycle in most of those economies is projected to come to an end.

Central banks in several commodity-importing economies in East and South Asia, including China, Malaysia, Pakistan and the Republic of Korea, raised interest rates in 2017 and 2018. Nevertheless, given the high degree of external uncertainty, central banks are expected to remain cautious. In several countries, particularly in the African region, monetary policy remains tight, given weakened domestic currencies and elevated inflation rates.

Procyclical fiscal policy expansion in the United States

16. Against the backdrop of a synchronized upturn in economic activity, Governments in most developed countries have adopted a broadly neutral fiscal policy stance for 2018–2019. The main exception is the United States. Recently passed budget changes are expected to boost economic growth in the near term, while significantly increasing the public deficit and debt over the medium term (see section II). With the economy close to full employment, the fiscal expansion is highly procyclical. Such an increase in debt is unusual outside a recession, leaving fiscal policy with far less room to respond to the next economic downturn.

17. Fiscal policy in the European Union, by contrast, is expected to have a neutral impact on growth in the period 2018–2019, as many countries have moved away from austerity in recent years. Across the region, stronger GDP growth and significant labour market gains have driven cyclical improvements in budget balances by boosting tax revenues and reducing welfare expenditure. Almost all European countries are projected to record a primary balance surplus in 2019 but the region's aggregate debt-to-GDP ratio remains high and is expected to decline only slowly.

Easing fiscal pressures for commodity exporters

18. Higher commodity prices and a gradual recovery in GDP growth are expected to ease fiscal pressures in many developing and transition economies, including major commodity exporters such as Brazil, the Russian Federation and Saudi Arabia. General government balances will nonetheless remain in deficit and debt-to-GDP ratios are expected to rise further in many African, Latin American and Western Asian economies. Fiscal policy will thus remain relatively tight in the forecast period. In East and South Asia, fiscal policy remains supportive of growth, focusing on infrastructure spending and the expansion of social welfare systems. Fiscal deficits in the region are expected to remain broadly stable. In China, the budget deficit target has been reduced from 3 per cent of GDP in 2017 to 2.6 per cent in 2018, the first targeted decline in several years. Further discussion on regional policy developments is included in section II.

C. Risks to the outlook

19. The baseline forecast set forth in the present report, which represents the most likely trajectory for the global economy, points to further improvement in short-term prospects. Nonetheless, there are significant downside risks that have the potential to reverse recent improvements.

Escalation of trade policy disputes

20. Trade tensions among many of the world's largest economies have been building. Major agreements, such as the North American Free Trade Agreement, have undergone prolonged renegotiation and a range of tariff and trade barriers have been put forward by major economies. In addition to such measures, taken outside the purview of the World Trade Organization (WTO), a growing number of disputes have been raised within WTO in recent months, including cases involving Australia,

Canada, China, India, Pakistan, the Republic of Korea, the Russian Federation, Ukraine, the United Arab Emirates, the United States and Viet Nam. A move towards a more fragmented international trade landscape could reverse recent improvements in the global economy. A sharp increase in trade barriers and disputes could slow trade and investment considerably in the short term and hamper medium-term global growth, given the deep links between trade, investment and productivity growth.

21. The direct impact of measures that have been introduced and proposed in recent months, including proposed tariffs on $50 billion worth of exports from China and from the United States (equivalent to between 0.2 and 0.4 per cent of GDP in each country), would be relatively modest at the macroeconomic level. The baseline forecast set forth in the present report sees world trade growth slowing modestly in 2018 but remaining relatively robust at 3.8 per cent, on the assumption that trade tensions do not escalate significantly and global spillover remains contained. Under an alternative scenario, spiralling trade tensions and rapidly rising barriers over the course of 2018, through widespread retaliation and extensive disruption to global value chains, could trigger a sharp drop in global investment and trade. For example, a shock to investment and trade equivalent to roughly half the losses seen during the global financial crisis could bring trade growth to a halt and slow world gross product growth to 1.8 per cent in 2019, compared with baseline projections for growth of 3.2 per cent.[2]

Build-up of financial risks

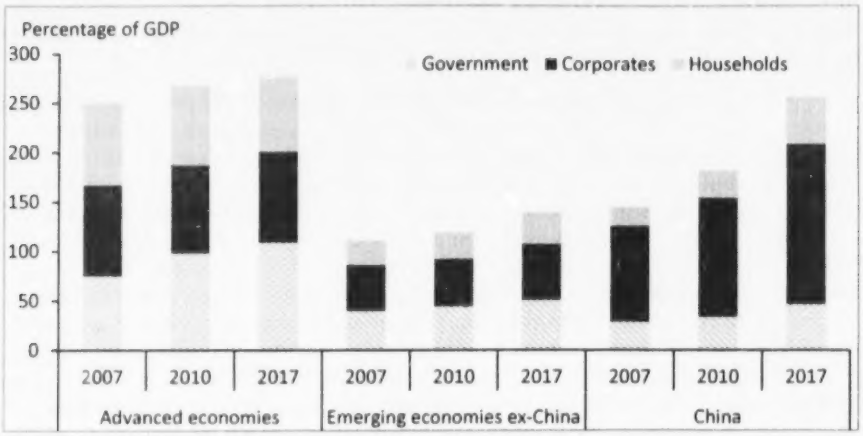
22. Global financial conditions remain relatively conducive to investment but risks have been building in recent years. The prolonged period of abundant global liquidity and low borrowing costs has not translated into a sustained, widespread and robust recovery of investment. On the contrary, it has mostly encouraged the issuance of debt securities, merger and acquisitions strategies and an increase in corporate buybacks. This has been associated with a significant rise in financial asset valuations and a substantial increase in debt levels across regions. Increased volatility in the global stock markets in early 2018 serves as a reminder that the vulnerabilities that have built up in many emerging economies leave them exposed to spikes in risk aversion, a disorderly tightening of global liquidity conditions and sudden capital withdrawal.

23. Elevated, and in some cases still rising, levels of debt are a prominent feature of the global economy. Public and private debt remains historically high in many developed economies and household and corporate debt is higher than before the global financial crisis. In emerging economies,[3] the debt-to-GDP ratio (all credit to non-financial sector) increased from 139 per cent in 2010 to nearly 200 per cent in 2017. Non-financial sector debt in China increased from 180 to over 250 per cent of GDP (see figure V). Debt levels also rose markedly in Latin America: from 125 to 145 per cent in Brazil and from 56 to 77 per cent in Mexico. In many of those economies, a significant portion of that debt has been channelled towards real estate and financial assets rather than productive capital. The extent to which corporate debt is not backed by productive assets is a source of financial risk, which in some cases has the potential to spillover significantly to the world economy.

[2] Department of Economic and Social Affairs, World Economic Situation and Prospects: Monthly Briefing, No. 114 (May 2018). Available at www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/wesp_mb114.pdf.

[3] As defined by the Bank for International Settlements (see www.bis.org/statistics/tables_f.pdf).

Figure V
Breakdown of non-financial sector debt in advanced and emerging economies, 2007–2017



Source: Bank for International Settlements, total credit statistics.

24. As financial risks grow, policymakers face the challenge of enhancing resilience to external shocks and, in some cases, curbing credit growth and managing the pace of private sector deleveraging. If deleveraging occurs too rapidly, it could spark banking sector stress, corporate bankruptcies or sudden adjustments in asset prices. Many emerging economies have improved their macroeconomic management and are better prepared to make use of a wider policy toolkit through monetary, fiscal, exchange-rate and macroprudential policies and capital account management measures. Even so, appropriate policies to encourage an adequate level and composition of productive investments are also crucial to promoting productivity gains and lifting potential growth in the medium term.

25. Monetary policy adjustment in developed economies is progressing gradually but the procyclical nature of fiscal policy in the United States has added to uncertainty about the pace of adjustment and increased the probability of a more rapid withdrawal of monetary stimulus. That in turn encourages volatility in the global financial markets. Many developing countries are exposed to associated risks, in particular where a sizeable portion of the debt accumulated in recent years is denominated in dollars. The prospect of tighter liquidity and spikes in risk aversion expose emerging economies to the risk of higher borrowing costs, the depreciation of domestic currencies and a decline in equity prices. That could have an adverse impact on banking and corporate sector balance sheets and on the capacity to roll over debt. Moreover, the corporate sector will face a heavy debt-servicing schedule in the coming few years, especially in the case of a sudden appreciation of the United States dollar. The effects on real economic activity, through a sharp slowdown in investment, higher inflation or fiscal adjustment measures, could be considerable.

II. Economic outlook by region

A. Developed economies

26. The economy of the United States is operating at or close to full capacity. The unemployment rate has dropped to 4.1 per cent, which is below most estimates of its long-run equilibrium level, and the ratio of job openings to job seekers is at its highest

since at least 2000. Rising capacity utilization rates have supported a rebound of investment in equipment.

27. Although activity moderated slightly in the first quarter of 2018, prospects for the year remain firm, buoyed by major fiscal stimulus measures introduced in the Tax Cuts and Jobs Act of December 2017 and the Bipartisan Budget Act of 2018. GDP growth is expected to reach 2.5 per cent in 2018 and 2.3 per cent in 2019. The drop in average income tax rates by 2 percentage points since January 2018 will sustain steady household spending. That said, after-tax wage inequality is expected to continue to rise, as higher income households reap a greater share of tax cuts.

28. A steep decline in the corporate tax rate will continue to support investment in the near term. The budget also includes additional federal spending amounting to 1 per cent of GDP in the period 2018–2019. Those stimulus measures will lead the federal deficit to widen from 3.5 per cent of GDP in 2017 to about 5 per cent by 2019. Government debt will continue to rise relative to GDP for the next decade. The aggressive fiscal expansion, at a point when the economy is operating near full capacity, coupled with potential upward pressure on inflation from import tariffs, may accelerate the pace of interest rate rises by the Federal Reserve Bank.

29. In Canada, the economy registered exceptional growth of 3 per cent in 2017, driven by fiscal stimulus measures and strong gains in housing wealth. Economic activity is expected to expand at a more moderate but healthy pace of between 2 per cent and 2.2 per cent in 2018 and 2019. Elevated uncertainty regarding the renegotiation of the North American Free Trade Agreement will restrain the recovery in investment in the near term.

30. In Japan, the forecast for GDP growth for 2018 has been revised upward from 1.2 to 1.6 per cent, reflecting improvements in external and domestic demand. Domestic demand is supported by rising corporate profits and tightening labour market conditions. That should support a gradual increase in real wages, which will in turn exert some upward pressure on consumer prices in 2018. The potential for a sharp appreciation of the Japanese yen poses a key downside risk to the economy.

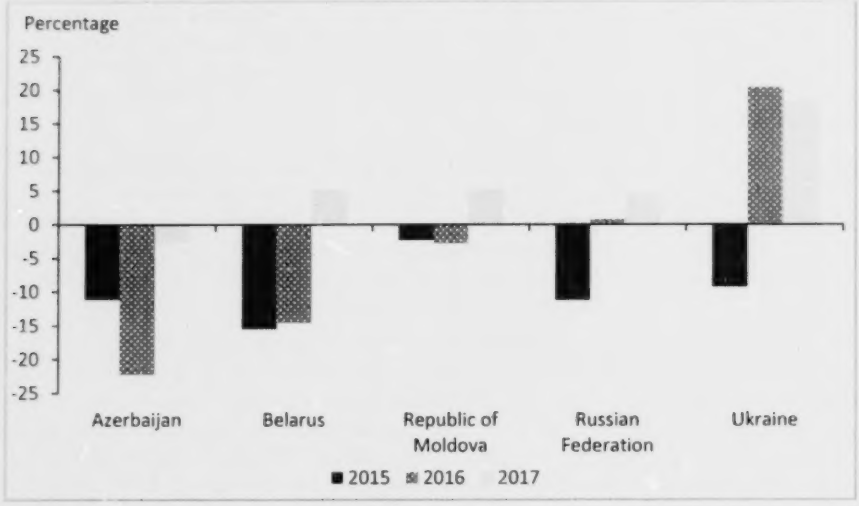
31. The growth outlook for Europe remains robust but downside risks are high. The euro area is projected to expand by 2.1 per cent in 2018 and 1.9 per cent in 2019, a marginal upward revision of the previous forecast. Strong private consumption growth is underpinned by dynamic labour market conditions and rising disposable incomes. Business investment and construction activity will also be supported by the loose monetary policy stance of the European Central Bank. Even so, downside risks to the region's outlook have increased. Amid rising trade tensions among major economies, various product groups have become the subject of new or changed tariff regimes. A widening of trade restrictions would pose a significant risk, especially to the export-reliant European economies. The transition phase that will follow the departure of the United Kingdom of Great Britain and Northern Ireland from the European Union will bring with it considerable uncertainty, in particular with regard to future trade relations between the two parties. That increases the risk of businesses diverting investments away from the United Kingdom. The European Central Bank faces the challenge of designing and communicating a normalization of its monetary policy stance, in terms of its asset purchases and the policy rate, which could become an additional source of financial market volatility.

32. Growth in the Eastern European and Baltic member States, driven by robust export performance and infrastructure spending, which has been boosted by a surge in the inflow of European Union funds, is expected to remain above the Union average. Nonetheless, rising debt and the potential build-up of housing bubbles pose medium-term challenges.

B. Economies in transition

33. Growth in the energy-exporting economies of the Commonwealth of Independent States (CIS), supported by higher oil prices and prudent macroeconomic policies, is expected to remain positive in 2018 and 2019. The Russian Federation exited recession in 2017, amid stronger private consumption and a moderate rebound in fixed investment, buoyed by preparations for the International Federation of Association Football World Cup in 2018. In early 2018, low inflationary pressures, a stable currency and the planned increase in public sector wages laid the groundwork for a further boost in consumer spending. The intensification of geopolitical tensions and the imposition of additional economic sanctions, however, have since complicated the activities of Russian companies and put downward pressure on the currency. That may spur inflation and curb consumer spending, thereby restraining growth to 1.7 per cent in 2018. In Kazakhstan, growth may exceed 3 per cent, driven by rising oil output and investment in transport infrastructure.

Figure VI
Real investment dynamics in selected Commonwealth of Independent States economies, 2015–2017



Sources: National statistics offices and central banks.
Note: Data for 2017 are preliminary.

34. Among CIS energy-importers, Ukraine recorded growth of 2.5 per cent in 2017, supported by a solid upturn in investment (see figure VI). Growth is projected to remain relatively stable in the outlook period, provided external financial assistance continues. The possible reduction in the amount of Russian natural gas transiting through the country presents a moderate downside risk to growth in 2019. In early 2018, remittance flows to the smaller CIS countries in Central Asia and the Caucasus remained robust, bolstering private spending, although the weakening of the Russian rouble presents a risk. Going forward, the Central Asian countries should also benefit from the implementation of the Belt and Road Initiative. Aggregate GDP of the CIS countries and Georgia is expected to increase by 2.1 per cent in 2018 and 2019.

35. The outlook is generally favourable for South-Eastern Europe, where aggregate GDP, supported by investment and exports, is expected to expand by 3 per cent in 2018 and 3.4 per cent in 2019.

C. Developing countries

Asia

36. The short-term growth outlook for East Asia remains robust, with regional GDP projected to expand at a steady pace of 5.8 per cent in 2018 and 5.7 per cent in 2019. Growth will be underpinned by resilient private consumption and public investment and the ongoing improvement in external demand.

37. In China, growth is expected to remain solid, owing to robust consumer spending and supportive fiscal policies. As structural reforms proceed, growth is projected to slow gradually from 6.9 per cent in 2017 to 6.5 per cent in 2018 and 6.3 per cent in 2019. Continued efforts to address financial vulnerabilities will contribute to more sustainable medium-term growth but the authorities face the policy challenge of ensuring that associated deleveraging does not derail growth in the short term.

38. Most other economies in the region are expected to experience stable GDP growth in the outlook period. Private consumption will remain the key driver of growth, supported by healthy job creation, low interest rates and modest inflationary pressures. In addition, consumer spending in Myanmar, the Republic of Korea, and Thailand will be further boosted by an increase in minimum wages in 2018. Growth in many countries, including Indonesia, the Philippines and Thailand, will also be supported by large infrastructure projects, which will help to alleviate structural bottlenecks and boost productivity growth in the medium term.

39. Downside risks have increased. A more restrictive global trade environment would have a significantly adverse effect on East Asia, given the region's high degree of trade openness and extensive global production networks. Geopolitical tensions in the Korean Peninsula could affect investor sentiment and regional financial markets and high corporate debt will continue to weigh on investment prospects in several countries.

40. The macroeconomic outlook in South Asia remains favourable, with robust domestic demand, strong infrastructure investment and moderately accommodative monetary policies. GDP growth is expected to strengthen to 6.6 per cent in 2018 and 6.8 per cent in 2019, following an expansion of 6 per cent in 2017. It is anticipated that regional inflation will remain stable and low. The positive outlook will provide an enabling environment for most countries in the region to make further progress in addressing their vast economic, social and environmental development challenges. Deeper reforms, such as the strengthening of fiscal accounts and tackling the region's large infrastructure gaps, are also needed to boost productivity gains and unleash the region's growth potential. Downside risks include setbacks on the reform agenda, heightened regional geopolitical tensions or a sharp rise in oil prices.

41. Growth in India, underpinned by robust private consumption, a slightly more supportive fiscal stance and benefits from past reforms, is gaining momentum. GDP growth is expected to climb to 7.5 and 7.6 per cent in the fiscal years 2017–2018 and 2018–2019, respectively. Although capital spending has shown signs of revival, a more widespread and sustained recovery in private investment remains a crucial challenge. In the Islamic Republic of Iran, the economic situation is expected to become more challenging in the near term, owing to the reimposition of trade, investment and financial sanctions by the United States. In addition, structural weaknesses in the economy stemming from long periods of under-investment will continue to constrain economic activity in the medium term. Among the smaller economies in the region, Pakistan is experiencing accelerating growth owing to vigorous investment and the gradual recovery of exports. The Bangladesh economy, benefiting from robust fixed investment and a broadly accommodative monetary

policy, is set to continue expanding by more than 7 per cent per annum in the near term. The fiscal stance in that country remains prudent, striking a delicate balance between consolidation efforts and advancing large infrastructure projects.

42. The forecast for GDP growth in Western Asia for 2018 has been revised upwards from 2.3 to 3.3 per cent, reflecting a stronger growth projection for Turkey. Economic growth in that country accelerated in the second half of 2017 on the strength of recovering domestic demand and stabilizing balance of payments. Growth in Israel remains robust, with low inflation and growing external demand. The member States of the Cooperation Council for the Arab States of the Gulf, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, are also expanding at a faster pace. Their non-oil sector has been growing steadily, supported by moderate demand growth in the public sector with the recovery in oil revenues. The monetary stance of the Gulf Cooperation Council countries has been tightened in line with that of the Federal Reserve Bank in the United States. Financing costs remain relatively stable and credit has continued to expand.

43. In Jordan and Lebanon, growth in domestic demand remains weak and inflation moderate. Reform plans linked to support from the international donors are likely to lead to a tightening of the fiscal stance in both countries. Despite ongoing armed conflicts, more signs of economic stabilization have been observed in Iraq and the Syrian Arab Republic. In Iraq, the economy is benefiting from the improved security situation. By contrast, economic recovery in the Syrian Arab Republic is constrained by its fragile balance-of-payments situation and economic sanctions. The crisis in Yemen remains dire, as fighting escalates and food security and the balance-of-payments situation deteriorate.

Africa

44. The forecast for regional growth in Africa has been revised upward since December 2017 to 3.6 per cent in 2018 and 3.9 per cent in 2019. The improvement reflects stronger prospects in some of the larger economies, such as those of Egypt and Nigeria. Nonetheless, per capita income growth, estimated at between 1.1 and 1.3 per cent in the period 2018–2019, remains insufficient to significantly alleviate poverty in the absence of dramatic declines in income inequality.

45. Although growth in Nigeria remains subdued, a recent improvement reflects terms-of-trade gains, recovering oil production, the greater availability of foreign exchange and more solid growth in the non-oil sector. That has driven a revision of the forecast for West Africa upward. North Africa is benefiting from lower inflation in countries such as Egypt and Libya. Ongoing political instability and security issues, however, continue to hold back the Libyan economy. Growth prospects for 2018 have improved in East Africa, as continued recovery from drought and new manufacturing infrastructure spur growth in Ethiopia. In Central Africa, fiscal consolidation and lower oil production are projected to constrain growth in 2018. The outlook for Southern Africa remains challenging, although growth in South Africa is expected to accelerate modestly in 2018 owing to stronger household consumption and improving investor confidence.

46. Average inflation in Africa remains on a downward trend, reflecting more stable exchange rates and lower food price inflation. That will allow monetary authorities, in particular in East and Southern Africa, to support economic activity through interest rate cuts. Among the fuel exporters, however, monetary policy is likely to remain tight.

47. Fiscal deficits should narrow slightly in aggregate, driven by spending cuts and concerns over rising levels of public debt. African sovereign debt is attracting record demand as Governments tap international markets and take advantage of relatively

low interest rates and strong demand from investors before policy tightening by the Federal Reserve Back in the United States drives up the cost of borrowing.

Latin America and the Caribbean

48. Against a backdrop of robust global growth and higher commodity prices, the recovery in Latin America and the Caribbean is expected to gain momentum in the period 2018–2019. Following growth of 1 per cent in 2017, it is projected that growth in the region will expand by 2.1 per cent in 2018 and 2.5 per cent in 2019 on the back of a broad-based upturn in economic activity. Except for the Bolivarian Republic of Venezuela, which has entered its fifth year of recession, all countries are expected to record positive growth, driven by strengthening private sector demand, especially in the commodity-exporting countries of South America. Private consumption and investment will be underpinned by modest inflation, low interest rates and, in some cases, improved confidence. Although the easing cycle in countries such as Brazil, Colombia and Peru is expected to come to an end, monetary policy will generally remain accommodative. Moreover, labour markets have shown signs of improvement. In many countries, the unemployment rate has edged lower over the past year, with employment in the manufacturing sector starting to recover. Higher commodity prices and the moderate recovery in growth have helped to ease fiscal pressure, in particular among the region's metals and agricultural exporters. That said, primary balances in many cases remain below debt-stabilizing levels, suggesting a need for further fiscal consolidation.

49. Although recovery is projected, the rate of expansion in Latin America and the Caribbean during the forecast period is expected to remain well below the average of 3.2 per cent recorded between 1991 and 2012. The low levels of investment and weak productivity seen in recent years have raised concerns about a possible decline in growth, which could hinder progress towards achievement of the Sustainable Development Goals. Moreover, forecast risks remain tilted to the downside. An escalation of global trade tensions would have an adverse effect on the commodity exporters of South America and on Central American and Caribbean countries with close ties to the United States. In addition, prolonged uncertainty arising from the renegotiation of the North American Free Trade Agreement could weaken the economic outlook in Mexico.

III. Key policy challenges

Unilateral trade measures and the multilateral trading system

50. Tensions over trade between the world's largest economies have increased significantly, which could have major negative fallout for global trade. In 2017, the Government of the United States initiated a sweeping review of existing trade deals. Following a series of investigations, including with regard to national security[4] and the acts, policies and practices of the Government of China relating to technology transfer, intellectual property and innovation,[5] the United States has proposed a series of measures aimed at protecting domestic industries on security grounds or from perceived imbalances in market access. In the first quarter of 2018, the United States imposed new tariffs on a range of products, including steel and aluminium (for security reasons) and washing machines and solar panel cells (as safeguard measures). The United States also announced plans to impose a 25 per cent tariff on imports of

[4] United States, Department of Commerce, *The Effect of Imports of Steel on the National Security* (Washington, D.C., 2018).

[5] United States, *Federal Register*, vol. 82, No. 163, pp. 40213–40215 (Washington, D.C., Office of the Federal Register, 2017).

more than 1,000 products from China, worth approximately $50 billion. In response, major trading partners, including Canada, China, the European Union and the Republic of Korea, began to draw up plans for retaliatory measures. At the same time, all parties are seeking to resolve the disputes at WTO. Although the situation remains in flux, it constitutes a clear move away from unambiguous support for the multilateral trading system.

51. World Trade Organization agreements include provisions allowing differential treatment for developing and developed economies in trade agreements in order to support the development dimension of the trading system. They also include provisions for countries to charge additional import duties to compensate for damage caused by "unfair" trading practices, a clause used to justify some of the recently proposed measures. Nonetheless, a fundamental principle of WTO is to encourage trade by lowering trade barriers between countries.

52. The use of tariffs and trade barriers is often seen as a way to protect domestic industries and employment against external competition. Frequently, however, such moves can prove to be self-defeating. Assessing the macroeconomic impact of a single tariff requires an understanding not only of the direct impact on the targeted sector but also of the indirect impact elsewhere in the economy. A tariff on steel imports may preserve or create jobs in the steelmaking industry by rendering domestic firms better able to compete with lower-cost producers abroad. That depends on the ability of domestic suppliers to expand production. The tariff also has an indirect impact on downstream steel-consuming industries and consumers more broadly. For the steel-consuming industries, the tariff raises production costs and may squeeze the profits of firms, potentially leading to job losses or lower wages in those industries. In addition, higher steel prices feed in to the broader economy through higher consumer prices, thereby dampening overall household demand.

53. The net impact of any tariff on the broader economy will depend on the relative magnitudes of the direct and indirect channels described above and on spillover and reactions in the rest of the world. The introduction of a tariff in a large country would be expected to put downward pressure on international prices of the targeted product. For example, a tariff on steel in the United States may reduce demand for imported steel and further aggravate the glut of steel supplies in global markets. Trade restrictive measures can also disrupt the intricate global and regional production networks that have evolved under existing policy, with a potentially significant impact on many smaller developing countries integrated into those supply chains. In addition, tariffs may provoke retaliatory measures by other countries, which may constrain exports and increase uncertainty and have an adverse impact on business confidence and investment. In some cases, however, trade diversion may benefit countries exempt from the new barriers. For example, a tariff on soybean exports from the United States to China could increase Chinese demand for soybeans from other countries, such as Brazil.

54. A further intensification of trade barriers and retaliatory measures would mark a step back from efforts to revitalize the Global Partnership for Sustainable Development through progress towards building a universal, rules-based, open, non-discriminatory and equitable multilateral trading system and undermine some of the basic objectives of WTO.

A. Inequality and inclusive growth

55. The continued improvement in global macroeconomic conditions offers an opportunity to raise living standards on a broad scale, especially in developing regions. Stronger economic growth, however, is not sufficient to ensure that those

gains are widely shared. The reduction of the inequality within and among countries (Goal 10 of the Sustainable Development Goals) is a key to inclusive growth and shared prosperity. Many of the Goals and related targets on poverty, health and education are linked to overcoming inequality.

56. The relationship between income inequality and growth at the country level is complex; country-specific factors such as the size of the economy, the degree of development and the institutional and political environment play a major role. In some theoretical literature of the twentieth century, inequality was viewed as an incentive to increase efforts at work and in education or as a factor encouraging higher rates of domestic savings. Empirical evidence now increasingly suggests that high inequality hinders economic growth.[6] High income inequality is often associated with social tensions and political instability, which in turn can hamper growth-supporting investment. Inequality can also hinder the accumulation of human capital and social mobility, dampening short-term and medium-term economic prospects. Such inequality is also often linked to the exertion of disproportionate political influence by certain interest groups, resulting in market concentration and a lack of competition, which in turn hamper productivity growth.

57. The significant rise in income inequality in most developed and developing countries throughout the 1980s and 1990s is well documented. In many cases, inequality, as measured by Gini coefficients or the income shares of the top 10 per cent of earners, reached levels unprecedented since the Second World War. The increase in overall inequality can be attributed to the declining labour share of income and rising wage inequality. Numerous factors contributed to those trends. Chief among them were: privatization, liberalization and deregulation; skill-biased technological change; less progressive tax systems; the weakening of labour market institutions; and a decline in public capital. Widening income inequality, although not universal, prevailed across all major regions during that period.

58. The picture has become more mixed since the early 2000s. Inequality continued to rise in most developed economies, in particular European countries affected by the global financial crisis, where unemployment rose sharply and severe austerity measures were imposed. In most developing countries, in particular in Latin America and parts of Africa, inequality remains extraordinarily high, holding back productivity and growth. Recent data, however, have shown some modest improvement in inequality trends. In most developing and transition economies for which such data are available, Gini coefficients were lower in the period 2014–2015 than in the years 2005–2008 (see figure VII). At the same time, the income share held by the top 10 per cent of earners declined slightly in most of those economies. In two out of three countries, mean incomes grew faster for the bottom 40 per cent than for the total population from 2008 to 2013.[7] In part, those gains may be temporary cyclical reactions (for example, a temporary decline in the capital income share) to the global financial crisis.[8] In some cases, however, the positive trends reflect more structural, longer-term changes. The region with the most uneven distribution of income, Latin America and the Caribbean, has made significant progress in reducing inequality in the past 15 to 20 years. Four factors have contributed to the observed reduction in Gini coefficients throughout the region: a relative rise in the labour income of poor workers, partly as a result of higher minimum wages; an increase in the average level of education of adults; increased government transfers to households in the form of

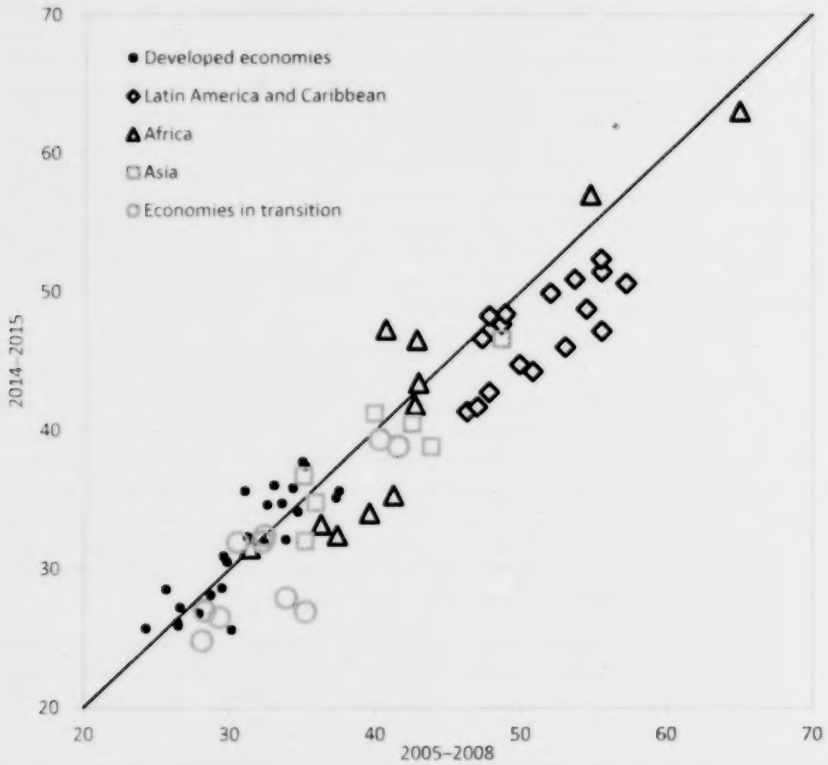
[6] Jonathan D. Ostry, Andrew Berg and Charalambos G. Tsangarides, "Redistribution, inequality and growth", Staff Discussion Note (Washington, D.C., International Monetary Fund, 2014).

[7] World Bank, *Poverty and Shared Prosperity: Taking on Inequality*, (Washington, D.C., 2016).

[8] International Monetary Fund, *World Economic Outlook, April 2017: Gaining Momentum?* (Washington, D.C., 2017).

targeted social programmes; and a demographic dividend, with an increase in the share of working-age people.[9]

Figure VII
Gini index, 2005–2008 and 2014–2015



Sources: World Bank and CEIC data.
Note: Figure includes a subset of countries in each region for which data are available. A higher value of the Gini coefficient indicates a higher level of inequality.

59. In East Asia, greater policy effort in the past decade has been geared towards addressing income inequality. Measures have included the implementation of major infrastructure plans, which have generated jobs for low-skilled and migrant workers; the review of minimum wage policies; the introduction of cash handouts for the poor; and the strengthening of pension systems. In the former centrally planned economies of Central and Eastern Europe and CIS, inequality also declined in the aftermath of the global financial crisis, after having increased sharply during the economic transition of the 1990s and early 2000s.

60. Levels of inequality remain high in many developing countries but recent positive experiences illustrate the role institutions and policies play in promoting a more equitable distribution of the gains from growth. The current benign global economic environment presents an opportunity to accelerate progress in that direction.

[9] Suzanne Duryea and others, *Social Pulse in Latin America and the Caribbean 2016: Realities and Perspectives* (Washington, D.C., Inter-American Development Bank, 2016).

B. Economic growth and the environment

61. The recent spurt in economic growth has come at a cost to the environment. Contrary to what is required, global energy-related carbon dioxide (CO_2) emissions increased by 1.4 per cent in 2017, according to the International Energy Agency, owing to the acceleration of global economic growth, the relatively low cost of fossil fuels and a slackening in energy efficiency efforts. The Agency has warned that, at the present rate, efforts to combat climate change are insufficient to meet the objectives of the Paris Agreement.

62. According to the National Aeronautics and Space Administration, 2017 was the second hottest year on record; the hottest was 2016.[10] Global temperatures have followed a rapid warming trend for the past 40 years. The average surface temperature of the planet has risen about 1°C in the past century. That rise is attributed largely to the accumulation of CO_2 and other human-made greenhouse gas emissions in the atmosphere. The Intergovernmental Panel on Climate Change calculates that by 2100 global temperatures will have risen by between 4°C and 6.1°C relative to pre-industrial levels if no meaningful action is taken to mitigate the growth of greenhouse gas emissions.[11] It is the stated goal of the Paris Agreement to limit that increase in global average temperature to well below 2°C.

63. Evidence indicates that in countries with relatively high temperatures, including most low-income countries, growth of GDP per capita slows as temperatures increase.[12] Potential channels of transmission include shifting rainfall patterns that may lead to changes in where arable farmland is located;[13] rising sea levels, which threaten small island developing States in particular, but also some of the world's most valuable infrastructure and sizable populations; and increased frequency and intensity of extreme weather events. The ensuing damage will have an impact on agricultural production, labour productivity in sectors that are vulnerable to weather conditions, capital accumulation and human health, spurring large-scale episodes of migration. Natural disasters are already responsible for the highest number of new internally displaced persons each year: in 2016, the number of newly displaced persons because of disasters was 3.5 times higher than those owing to conflict and violence.[14]

64. While recent evidence points to progress in decoupling increases in emissions from GDP growth in some developed economies,[15] it is still manifestly insufficient. The rate of global energy efficiency gains has been slowing since 2015, reaching 1.7 per cent in 2017, which is half the rate required to remain on track with the Paris Agreement.[16] Low fossil-fuel prices and changes in energy policies lie behind the slowdown. Reform of fossil fuel subsidies and taxation could contribute to accelerating the rate of energy efficiency gains and may be more easily implemented while fossil fuel prices are low.

---

[10] National Aeronautics and Space Administration, "Long-term warming trend continued in 2017: NASA, NOAA", 18 January 2018.

[11] Intergovernmental Panel on Climate Change, *Climate Change 2013: The Physical Science Basis* (New York: Cambridge University Press, 2013), p. 1,101.

[12] International Monetary Fund, *World Economic Outlook* (2017).

[13] Intergovernmental Panel on Climate Change, *Climate Change 2014: Synthesis Report* (Geneva, 2014), p. 16.

[14] International Displacement Monitoring Centre, *Global Report on Internal Displacement* (Geneva, 2017).

[15] Gail Cohen and others, "The long-run decoupling of emissions and output: evidence from the largest emitters", Working Paper No. 18/56 (Washington, D.C., International Monetary Fund, 2018).

[16] International Energy Agency, *Global Energy and CO_2 Status Report 2017* (Paris, 2018).

65. The development and deployment of renewable energy technologies such as wind, solar, electric vehicles and battery storage also remains crucially important. Renewables accounted for 61 per cent of all newly installed net power capacity in 2017; solar energy alone accounted for 38 per cent. That was made possible in part by falling costs for solar electricity and wind power, allowing some projects to become economically viable. Nevertheless, the pace of energy transition must accelerate further still.

66. Thanks to intensified plans to deploy renewables and electric vehicles, the International Energy Agency forecasts emissions growth of just 0.4 per cent per year between 2016 and 2040 (compared to an average annual growth of 2.2 per cent between 2000 and 2016). The current share of renewables in global power generation is thought to have prevented the emission of 1.8Gt of CO_2, or 5.5 per cent of total carbon emissions in 2017. That progress falls short of the need for emissions levels to peak as soon as possible and fall rapidly thereafter.

67. Renewable energy accounts for only 19 per cent of global power capacity and 12.1 per cent of global power generation (17 per cent including large hydroelectric projects), even with the recent high share of newly installed capacity. If the pace of power transition were to continue at that rate, by conservative estimates it would take at least 55 years before renewables accounted for half of total power capacity. Achieving the target set in the Paris Agreement therefore poses an immense challenge.

68. Developing countries continue to invest more in renewables than developed economies, with notable investment surges in countries such as Egypt, Mexico and the United Arab Emirates. Since 2004, China has displaced Europe as the dominant source of investment in renewables, in particular in 2017. Accounting for 45 per cent of global new investment in renewable energy, China is the world's largest investor.

69. Near-term challenges facing renewable energy include higher borrowing costs, waning policy support and the issue of integrating renewable energy generation capacity into the electricity grid. The costs of generating solar and wind power are falling, but securing finance may become more difficult and expensive in the near term as world interest rates rise and the withdrawal of government-backed price support affects the attractiveness of projects.